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SUBJECT: SCENE-SETTER FOR CODEL REID

¶1. (SBU) SUMMARY: Embassy Asuncion warmly welcomes CODEL Reid November 25-27. Your visit provides an opportunity to promote U.S. interests in strengthening democratic institutions, promoting sound economic policies and good governance, disrupting criminal organizations, and combating terrorist financing. You come at a particularly important time for Paraguay, with much of the body politic focused on presidential elections scheduled for April 2008. Many Paraguayans, both inside and outside the government, support closer political and economic ties to the United States. Your visit will help emphasize the USG's interest in strengthening ties with Paraguay. END SUMMARY.

The Political Scene

¶2. (SBU) Your visit comes four years into the five-year presidency of Nicanor Duarte Frutos. In that time, President Duarte has taken steps to deal with a pressing fiscal crisis, to revive the economy, and to fight corruption. In the last year, however, political support for Duarte has sagged, with polls indicating Paraguayans are not satisfied his government has taken adequate measures to create jobs, improve the economy and tackle corruption. Recent opinion polls placed Duarte's popularity rating at 11 percent, the lowest of any president in the Western Hemisphere.

¶3. (SBU) Regionally, Paraguay's relations are dominated by its larger neighbors, Argentina and Brazil. Paraguay works within the framework of MERCOSUR to secure economic concessions from its larger neighbors but has not experienced the significant benefits it hoped to extract from MERCOSUR membership. Paraguay has traditionally viewed the United States as a regional counter-balance. However, Duarte has increasingly criticized President Bush and stressed greater appreciation for Venezuelan President Chavez and Venezuela's "commitment" to the region.

¶4. (SBU) Duarte hand-picked former Minister of Education Blanca Ovelar to be his successor, and he intends to run for a Senate seat in the upcoming election. Duarte's former vice president, Luis Castiglioni, will compete with Ovelar for the Colorado Party's nomination (December 16). Castiglioni and Ovelar run neck-and-neck in recent public opinion polls. Several political "wild card" candidates have the potential to wreak havoc in the elections and end 60 years of Colorado Party rule (a world record). The Supreme Court October 30 overturned former General Lino Oviedo's conviction for his 1996 coup attempt against then-President Carlos Wasmosy. Following his release from prison and reinstatement of his full civil and political rights, Oviedo declared his intention to run for president. Resigned Catholic Bishop Fernando Lugo is the Liberals' chosen candidate, but he appears to be declining in public support. Lugo -- who had been leading all opinion polls until Oviedo's release -- also

faces a potential legal barrier to office because the constitution bars religious "ministers" from seeking the presidency.

Reforming the Economy, But Growth Insufficient

15. (U) Paraguay's formal economy, with a gross domestic product (GDP) of USD 9.1 billion in 2006, relies heavily on agricultural exports, especially beef, soy beans, and sugar cane. (NOTE: Paraguay supplies 95 percent of the United States' organic sugar. END NOTE.) Paraguay is also the world's largest exporter of electricity. The country generates substantial revenues from the Itaipu Dam for electricity used by its partner, Brazil, and from the Yacyreta Dam it shares with Argentina. (NOTE: Paraguay supplies 25 percent of Brazil's total electricity and most of the electricity used by Brazil's industrialized southern provinces. END NOTE.) State-owned monopolies that control key public sectors, including electricity, telecommunication, water, and sanitation, dominate the public sector. The private sector, which comprises a small percentage of Paraguay's GDP, consists of a variety of small-to-medium, service-oriented companies. The informal economy, estimated to be as much as one-half the size of the formal economy, perpetuates illicit transshipment of laundered money, drugs, contraband, and counterfeit products destined for Brazil, Argentina, and beyond.

16. (U) Paraguay's economic growth reached four percent in 2006, and inflation was 12.5 percent. The economy is expected to grow by four percent in 2007. Inflation remains high, and the currency (guarani) has surged against the U.S. dollar in the past year. Paraguay has focused on expanding agricultural production and finding markets for its products, particularly beef and soy beans. However, the country suffers from high unemployment resulting from a lack of investment in the private sector, increased farm and ranch consolidation, and an over-reliance on commodity exports. Despite the strong economy, many Paraguayans have emigrated to Argentina, Spain, and the United States seeking employment. As a result, overseas remittances have been become an increasingly large part of Paraguay's GDP, reaching an estimated eleven percent of GDP in 2007.

17. (U) Paraguay needs to sustain annual economic growth of at least five percent, and it must undertake deeper structural reforms to move from an agrarian economy to a modernized one.

Duarte focused on economic reform early in his term, but progress over the past three years has slowed. Conflicts between Congress and the Duarte administration have all but frozen any reform efforts. Congress rejected several Inter-American Development Bank (IDB), European Union, and Japanese development loans (Paraguay maintains a line of credit with the IDB) and suspended the implementation of a personal income tax for the next year. Duarte worked to expand trade relations through regional trading blocs such as MERCOSUR, and actively lobbied to join the Andean Trade Promotion and Drug Eradication Agreement (ATPDEA) to receive preferential trade treatment. As the 2008 election approaches, inadequate political will exists to take on tough economic reform.

International Crime, Corruption, and Counter Terrorism

18. (SBU) The Tri-Border Area (TBA), where Paraguay, Brazil, and Argentina meet, is a primary USG concern. The area, with its loose borders and lax controls, is a hub for trans-national criminal activity including drug trafficking, trafficking in persons, arms trafficking, intellectual piracy, document forgery, contraband, and money laundering. Brazil has tightened its border controls with positive results, but significant money continues to flow out of Ciudad del Este (CDE). Paraguay is widely regarded as the weakest link in combating the illicit activities that occur

in the TBA. Corruption at multiple levels undercuts law enforcement efforts. Nevertheless, Paraguay has taken serious steps to address its institutional deficiencies by creating special units, principally in Customs and the Ministry of Industry and Commerce (MIC) to investigate intellectual property rights (IPR) violations and customs fraud. The MIC's Specialized Technical Unit (UTE) has made significant seizures of counterfeit products with USG assistance. Paraguay's Anti-Money Laundering Secretariat (SEPRELAD) also receives U.S. technical assistance and support.

¶8. (SBU) Corruption in Paraguay's political and economic system undermines its efforts to modernize. Transparency International rated Paraguay the fourth-most corrupt country in Latin America in 2007, not far behind Haiti, Venezuela, and Ecuador. Corruption tends to peak prior to elections, and is also rampant in Paraguay's economy, particularly in public monopolies. Recent allegations that the director of the Itaipu Binational Enterprise, which oversees the Itaipu Dam, siphoned dam revenues for personal use, underscore corruption in Paraguay's economy. The USG has worked closely with local law enforcement officials and prosecutors to actively combat corruption. U.S. support for Paraguay's Trade Transparency Unit has resulted in the uncovering of USD four billion in goods illegally imported into the country.

¶10. (SBU) The Paraguayan Congress is considering a new criminal code which includes anti-money laundering provisions, and should become law before year's end. Although the Chamber of Deputies, or lower house, passed counter-terrorism (CT) legislation as part of the criminal code, the Senate -- faced with rising public protests fearing potential abuses -- removed it from the final version. Congress will also consider a new criminal procedures bill in the coming year.

¶11. (SBU) Paraguay is a major transshipment point for cocaine from Colombia and Bolivia to Brazil. Paraguay also provides most of the marijuana consumed in South America. The Anti-Drug Secretariat (SENAD), perhaps Paraguay's most effective law enforcement body, coordinates interdiction efforts with significant DEA assistance. Working closely with the United States, SENAD has effectively targeted Brazilian trafficking groups based in Pedro Juan Caballero (PJC) on Paraguay's northern border with Brazil. SENAD has made a number of significant arms seizures with evidence indicating links to Brazil's PCC and Colombia's FARC. Presently, SENAD is hard-pressed to meet challenges in CDE due to a lack of resources (its national annual budget is just \$2 million). SENAD inaugurated a helipad in PJC April 11, the second phase of a State Department-funded project to create a regional SENAD operational base.

¶12. (SBU) A culture of distrust hampers the ability of Paraguay's law enforcement community and military to tackle rising concerns about public security; Paraguay's National Police are widely disparaged by the general population as incompetent and corrupt. Of late, major robberies, including the August theft of USD one million at the airport in Asuncion, and kidnappings, including the September kidnapping of the granddaughter of former vice president Luis Maria Argana, are on the rise.

U.S. Activities

¶13. (SBU) USG activities in Paraguay focus on strengthening democratic institutions, promoting sound economic policies and good governance, disrupting criminal organizations, and combating terrorist financing. Post maintains bilateral assistance programs dealing with combating narcotics trafficking, money laundering, intellectual property violations, and trafficking in persons. A Department of Justice Resident Legal Advisor and advisors from Treasury's Office of Technical Assistance have worked behind-the-scenes over the last three years to assist the Paraguayan government

to add money laundering and other major reforms to the new criminal code currently pending in Congress. The 180-member Peace Corps contingency in Paraguay represents its third-largest group of volunteers and trainees worldwide.

¶14. (U) USAID manages a small but high-impact assistance program in Paraguay directed at key development constraints in democracy, health, economic growth and the environment. USAID's democracy programs are focused on anti-corruption activities, greater accountability and transparency in local government, and rule of law reform. USAID is also working to reduce poverty through its "Paraguay Vende" ("Paraguay Sells") program designed to help small and medium enterprises in poor areas of the country access new markets, increase sales, and create jobs. USAID's health programs are working to reduce maternal and child mortality and improve other critical health systems. USAID is also helping protect bio-diverse areas and promote better natural resources management. USAID also administers Paraguay's USD 35 million Millennium Challenge Account (MCA) Threshold Country Program (TCP), a two-year effort directed at reducing impunity, strengthening key institutions, and business formalization. The Threshold Program, which involves 28 Paraguayan institutions including the Congress and the Supreme Court, is at its midway point. Paraguay has made solid material progress under the program, but control of corruption remains an ongoing challenge. USAID's total non-TCP assistance to Paraguay this year totaled USD eight million.

The Military's Mission

¶15. (SBU) Paraguay's military is a small force struggling to redefine its mission despite insufficient funding and intermittent scandals. The Army is the largest of the three services (6,000), followed by the Navy (2,000) and Air Force (1,200). The military's primary missions are to protect Paraguay's territorial integrity, defend the government in accordance with the constitution, and cooperate in civil defense. It does not play a leading role in counter-drug operations, although the military provides a specialized tactical unit to support SENAD. The military's Special Forces unit is in the process of organizing a company-size counter-terrorism unit, and the Presidential Guard Unit has a specialized counter-terrorist platoon. More recently, Paraguay has attempted to increase its presence in international peacekeeping operations. Brazil supports Paraguay's deployment of 33 troops to Haiti; Paraguay is also training a 132-member engineering company to deploy worldwide as part of the Global Peacekeeping Operation Initiative (GPOI).

The Impact of Your Visit

¶16. (SBU) When meeting with local interlocutors, Post suggests you emphasize the United States' long history of friendship with Paraguay and our desire to continue close relations with Paraguay's next president, provided that s/he E is both elected and governs democratically. You might also highlight the importance of free and transparent elections and the important role international observers play in monitoring such elections. On trade, you might express interest in a continued dialogue to expand Paraguay's access to U.S. markets, but lower Paraguay's expectations about receiving ATPDEA trade benefits. It would be useful to recognize Paraguay's progress in fighting corruption and formalizing its economy via its Milenium Challenge Account Threshold Program, and encourage them to take full advantage of that program. Support for final passage of the Senate's version of the criminal code -- with strong sanctions against intellectual property rights violations and money laundering -- would be a clear sign of Parguary's seriousness to improve its international image. You might express gratitude to Paraguay for hosting the January 10-11 "3 plus 1" group

meeting on counter-terrorism, as well as the Joint Council on Trade and Investment (JCTI) conference December 4 which will touch on trade and intellectual property issues. Finally, it would also be helpful to encourage Paraguay to continue its efforts to train and support its contingent of UN peacekeepers, and offer continued U.S. military assistance via training programs and exchanges.

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